80-243

No.

In the Supreme Court of the United States

OCTOBER TERM, 1979

UNITED STATES OF AMERICA, APPELLANT

v.

E. M. AND B. L. DARUSMONT

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF CALIFORNIA

JURISDICTIONAL STATEMENT

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JURISDICTIONAL STATEMENT

QUESTION PRESENTED

Whether amendments to the minimum tax enacted on October 4, 1976, that increased the effective rate and broadened its applicability, can be constitutionally applied to transactions during the entire taxable year beginning January 1, 1976.

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OPINION BELOW

The findings of fact and conclusions of law of the district court (App. A, *infra*, 1a–4a) are not officially reported.

JURISDICTION

The judgment of the district court was entered on May 23, 1980 (App. B, *infra*, 5a–6a). A notice of appeal to this Court was filed on June 20, 1980 (App. C, *infra*, 7a–8a). The jurisdiction of this Court rests on 28 U.S.C. 1252, which authorizes a direct appeal to this Court from a final judgment of a court of the United States holding an Act of Congress unconstitutional in a civil action to which the United States is a party. A direct appeal lies where, as here, a statute is ruled unconstitutional as applied to particular circumstances. *Fleming* v. *Rhodes*, 331 U.S. 100 (1947). See *United States* v. *Christian Echoes Ministry, Inc.*, 404 U.S. 561, 563 (1972).

STATUTES INVOLVED

Sections 56 and 57 of the Internal Revenue Code of 1954 (26 U.S.C.), as amended by Section 301 of the Tax Reform Act of 1976, Pub. L. No. 94–455, 90 Stat. 1549, together with Section 301(g)(1) of the Tax Reform Act of 1976, 90 Stat. 1553, are set forth in App. D, *infra*, 9a–11a.

STATEMENT

On April 1, 1976, appellee E.M. Darusmont's[1] employer notified him that he was being transferred from Houston, Texas to Bakersfield, California (Darusmont Dep. 6–8).[2]

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[1] "Appellee" refers to E.M. Darusmont. B.L. Darusmont is a party to this action solely because she filed a joint return with her husband for 1976.

[2] References are to the original record on appeal.

He therefore undertook to sell his Houston residence, which was a three-unit house in which he occupied one unit and rented the remaining two units. Appellee retained the real estate firm of Coldwell Banker to assist him with the sale. Coldwell Banker advised appellee of a number of ways in which the house could be sold, including selling it as separate condominium units or as a whole and either for cash or on an installment basis (Darusmont Dep. 8–10).

On July 15, 1976, appellee sold the entire house for cash, thereby realizing a long-term capital gain. Because appellee purchased a replacement residence in California, he was able to defer recognition of the portion of the gain attributable to the unit of the house that he occupied pursuant to Section 1034 of the Internal Revenue Code of 1954. Appellee recognized gain on the sale of the other two units equal to $51,332.[3] After taking into account the deduction for one-half of net capital gains permitted by Section 1202 of the Code,[4] appellee included the remaining one-half of this gain in his taxable income. Appellee timely filed a joint income tax return with his spouse showing a 1976 income tax liability of $25,384, which was timely paid (Complaint).

This case involves the portion of appellee's liability, $2,280, attributable to the minimum tax, imposed by Section 56 on items of tax preference as defined in Section 57. The minimum tax (originally Sections 56, 57 and 58 of the 1954 Code) was enacted in 1969. Tax Reform Act of 1969, Pub. L. No. 91–172, Section 301, 83 Stat. 580. Originally, the minimum tax was imposed in addition to the regular

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[3]See App. C to the Memorandum for the Defendant in Support of its Motion for Reconsideration of its Motion for Judgment on the Pleadings.

[4]For years beginning after October 31, 1978, this deduction was increased to 60% of the net capital gain. Revenue Act of 1978, Pub. L. No. 95–600, Section 402, 92 Stat. 2867.

income tax, and was equal to 10% of the amount by which the total amount of the items of tax preference exceeded the sum of a $30,000 exemption and the taxpayer's regular income tax liability.

During the period in issue, one of the items of tax preference for individuals was the amount of the Section 1202 deduction for one-half of net capital gains (26 U.S.C. 57(a)(9)(A)). Accordingly, appellee's Section 1202 deduction for one-half of the capital gain recognized on the sale of his house was an item of tax preference. If the original exemption equal to the sum of $30,000 plus the regular tax liability had been retained for the year 1976, appellee would not have owed any minimum tax as a result of the sale of his house.

On October 4, 1976, however, the President signed the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520. Section 301 of that Act, 90 Stat. 1549, increased the rate of the Section 56 minimum tax from 10% to 15% and reduced the amount of the exemption to the greater of $10,000 or one-half of the regular tax liability (with certain adjustments). See Section 56(a) and (c). Section 301(g)(l) of the 1976 Act, 90 Stat. 1553, with exceptions not here relevant, provided that "the amendments made by this section shall apply to items of tax preference for taxable years beginning after December 31, 1975."[5] As a result,

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[5]For tax years beginning after December 31, 1978, Congress has widened the scope of the minimum tax. Section 55 was added to the Internal Revenue Code of 1954 by Section 421(a) of the Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2871, and provides what is called the "alternative minimum tax" for taxpayers other than corporations. Section 56 still provides for the standard minimum tax, while Section 57 still lists and defines the items of tax preference. The untaxed portion of capital gains, however, is now an item of tax preference only for purposes of the alternative minimum tax imposed by Section 55 and not for purposes of the standard minimum tax imposed by Section 56. See the last sentence of Section 57(a).

one-half of the net capital gain that appellee recognized on the July 15, 1976 sale of his house was subject to a minimum tax of $2,280.

Upon the denial of his claim for refund of $2,280 of minimum tax, appellee instituted this refund suit in the United States District Court for the Eastern District of California. He argued that the 1976 amendments to the minimum tax provisions could not constitutionally be applied to transactions entered into prior to the enactment of the Tax Reform Act. In support of his argument, appellee asserted that, had he known that the sale of his house would have triggered a liability for the minimum tax, he could have structured the sale so as to avoid that tax[6] (Complaint, Exh. A). The district court upheld appellee's claim. It ruled that the application of the 1976 amendments to transactions consummated in that part of 1976 prior to enactment subjected appellee "to a new, separate and distinct tax" and was "so arbitrary and oppressive as to be a denial of due process" guaranteed by the Fifth Amendment (App. A, *infra*, 3a).

THE QUESTION IS SUBSTANTIAL

The ruling of the district court—that an amendment to a taxing statute cannot constitutionally be applied to transactions occurring in the same taxable year as, but prior to, its enactment—is contrary to a settled line of decisions of this Court. If the judgment of the district court is permitted to stand, the power of Congress to enact any

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[6]The evidence below was conflicting with regard to appellee's reliance on existing tax law in structuring the sale. For example, in his deposition, appellee stated that "the main reason" he sold his house for cash was to avoid trips back to Houston to check up on the property (Darusmont Dep. 10). Further, appellee conceded that when he was considering the various ways in which he could dispose of his property, he was not even aware of the existence of the minimum tax (Darusmont Dep. 12, 16).

revenue statute with an effective date prior to the date of enactment will be drawn into question. Such limited retroactive application of taxing statutes—if, indeed, the term "retroactive" accurately characterizes an amendment applicable to the net results of the aggregate of transactions for the year of enactment—is the customary congressional practice.[7] Thus, the decision of the district court threatens to affect adversely the administration of the revenue by circumscribing what had heretofore been regarded as the unquestioned prerogative of Congress in enacting tax statutes. Moreover, in ruling that application of the 1976 minimum tax amendments to transactions occurring prior to October 4, 1976, is "so arbitrary and oppressive as to be a denial of due process" (App. A, *infra*, 3a), the decision of the district court squarely conflicts with *Buttke* v. *Commissioner*, No. 79-1885 (8th Cir. July 9, 1980), aff'g 72 T.C. 677 (1979).[8]

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[7] Cf. Slawson, *Constitutional and Legislative Considerations in Retroactive Lawmaking*, 48 Calif. L. Rev. 216 (1960); Ballard, *Retroactive Federal Taxation*, 48 Harv. L. Rev. 592 (1935).

See, *e.g.*, Income Tax Act of 1913, ch. 16, Section II D, 38 Stat. 168; Revenue Act of 1916, ch. 463, Sections 8(b), 13(b), 39 Stat. 761, 771; Revenue Act of 1917, ch. 63, Sections 1, 2, 4, 40 Stat. 300-302; Revenue Act of 1918, ch. 18, Section 200, 40 Stat. 1058; Revenue Act of 1921, ch. 136, Section 200(1), 42 Stat. 227; Revenue Act of 1924, ch. 234, Section 200(a), 43 Stat. 254; Revenue Act of 1926, ch. 27, Section 200(a), 44 Stat. 10; Revenue Act of 1928, ch. 852, Sections 1, 48(a), 45 Stat. 795, 807; Revenue Act of 1932, ch. 209, Sections 1, 48(a), 47 Stat. 173, 187; Revenue Act of 1934, ch. 277, Sections 1, 48(a) and (b), 48 Stat. 683, 696; Revenue Act of 1936, ch. 690, Sections 1, 48(a) and (b), 49 Stat. 1653, 1669; Revenue Act of 1938, ch. 289, Sections 1, 48(a) and (b), 52 Stat. 452, 475; Internal Revenue Code of 1939, Sections 1, 48(a) and (b) (26 U.S.C. (1946 ed.)); Internal Revenue Code of 1954, Section 7851(a)(1)(A) (26 U.S.C.).

[8] The question presented is also pending in three other courts of appeals. *Metzger* v. *United States*, No. 78-0346-S (S.D. Cal. Feb. 16, 1979), appeal pending, No. 79-3184 (9th Cir.); *Westwick* v. *Commissioner*, 38 T.C.M. 1269 (1979), appeal pending, No. 79-2245 (10th Cir.); *Estate of Lewis* v. *Commissioner*, 40 T.C.M. (CCH) 78 (Apr. 2, 1980), appeal pending, No. 80-1736 (5th Cir.).

1. This Court has long held that the application of income tax statutes to the entire year of enactment does not *per se* violate the Due Process Clause of the Constitution. See, *e.g.*, *Stockdale* v. *Insurance Companies*, 87 U.S. (20 Wall.) 323, 331, 332, 341 (1873); *Brushaber* v. *Union Pac. R.R.*, 240 U.S. 1, 20 (1916); *Cooper* v. *United States*, 280 U.S. 409, 411 (1930); *Milliken* v. *United States*, 283 U.S. 15, 21 (1931); *Reinecke* v. *Smith*, 289 U.S. 172, 175 (1933); *United States* v. *Hudson*, 299 U.S. 498, 500–501 (1937); *Welch* v. *Henry*, 305 U.S. 134, 146, 148–150 (1938); *Fernandez* v. *Wiener*, 326 U.S. 340, 355 (1945).[9] Thus, in *Brushaber* v. *Union Pac. R.R.*, *supra*, the Court held that the income tax enacted on October 3, 1913, could constitutionally reach income earned after March 1, 1913. As the Court stated (240 U.S. at 20, quoting from *Stockdale* v. *Insurance Companies*, *supra*, 87 U.S. (20 Wall.) at 331):

> "The right of Congress to have imposed this tax by a new statute, although the measure of it was governed by the income of the past year, cannot be doubted; much less can it be doubted that it could impose such a tax on the income of the current year, though part of that year had elapsed when the statute was passed."

Twenty years later in *United States* v. *Hudson*, *supra*, 299 U.S. at 500, the Court reaffirmed the teaching of *Brushaber:*

> As respects income tax statutes it long has been the practice of Congress to make them retroactive for relatively short periods so as to include profits from transactions consummated while the statute was in process of enactment, or within so much of the calendar year as preceded the enactment; and repeated de-

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[9] See Ballard, *Retroactive Federal Taxation*, 48 Harv. L. Rev. 592 (1935); Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation*, 73 Harv. L. Rev. 692, 706–711 (1960).

cisions of this Court have recognized this practice and sustained it as consistent with the due process of law clause of the Constitution.

The lower courts have uniformly followed these decisions.[10] Indeed, apart from the decision below, every court that has addressed the question presented has held that the application of the increase in the effective rate and scope of the minimum tax to the beginning of 1976 does not violate the Due Process Clause. *Buttke* v. *Commissioner*, *supra*; *Estate of Kearns* v. *Commissioner*, 73 T.C. 1223 (1980); *Estate of Lewis* v. *Commissioner*, 40 T.C.M. 78 (CCH) (Apr. 2, 1980), appeal pending, No. 80-1736 (5th Cir.); *Schopp* v. *Commissioner*, 40 T.C.M. (CCH) 275 (Apr. 29, 1980); *Westwick* v. *Commissioner*, 38 T.C.M. 1269 (1979), appeal pending, No. 79-2245 (10th Cir.); *Appendrodt* v. *United States*, 490 F. Supp. 490 (W.D. Pa. 1980); *Metzger* v. *United States*, No. 78-0346-S (S.D. Cal. Feb. 16, 1979), appeal pending, No. 79-3184 (9th Cir.). It is therefore hardly surprising that the court below reached its unique conclusion that "the retroactive application of the statute herein involved is so arbitrary and oppressive as to be a denial of due process" (App. A, *infra*, 3a) without the citation of a single supporting authority.

2. There are important reasons underlying the decisions upholding the application of income taxes to the entire year of enactment. The income tax is neither a penalty imposed upon a taxpayer, nor a liability assumed by contract. To the contrary, it is simply a means of apportioning

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[10] See, *e.g.*, *Prescott* v. *Commissioner*, 561 F.2d 1287, 1294 (8th Cir. 1977); *Purvis* v. *United States*, 501 F.2d 311, 313-314 (9th Cir. 1974), cert. denied, 420 U.S. 947 (1975); *Picchione* v. *Commissioner*, 440 F.2d 170, 173 (1st Cir.), cert. denied, 404 U.S. 828 (1971); *Cohan* v. *Commissioner*, 39 F.2d 540, 545 (2d Cir. 1930); *First National Bank in Dallas* v. *United States*, 420 F.2d 725, 729 (Ct. Cl.), cert. denied, 398 U.S. 950 (1970); *Rose* v. *Commissioner*, 55 T.C. 28, 31 (1970).

the cost of government. *Welch* v. *Henry*, *supra*, 305 U.S. at 146–147. Every taxpayer at the end of the year is called upon to contribute to that cost. The application of a tax to the beginning of a calendar year permits Congress better to allocate the cost to those taxpayers who it determines should bear it. Cf. *Shanahan* v. *United States*, 447 F.2d 1082, 1083 (10th Cir. 1971). Thus, Judge Learned Hand observed in *Cohan* v. *Commissioner*, 39 F.2d 540, 545 (2d Cir. 1930):

> Nobody has a vested right in the rate of taxation, which may be retroactively changed at the will of Congress at least for periods of less than twelve months; Congress has done so from the outset. * * * Such a one may indeed complain that, could he have foreseen the increase, he would have kept the transaction unliquidated, but it will not avail him; he must be prepared for such possibilities [the retroactive increase in tax rates], the system being already in operation.

The application of the amended minimum tax at issue here is therefore well within the boundaries of congressional authority. The 1976 amendments did not create a new tax, for the minimum tax already existed and the untaxed portion of capital gain income already was an item of tax preference.[11] The legislative history is plain,

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[11] The only revenue statutes that previously have been held void for retroactivity involved new types of taxes. Thus, the decisions in *Nichols* v. *Coolidge*, 274 U.S. 531 (1927) (estate tax), *Blodgett* v. *Holden*, 275 U.S. 142 (1927) (gift tax), and *Untermyer* v. *Anderson*, 276 U.S. 440 (1928) (gift tax), are inapposite and do not support the district court's decision that appellee has been unconstitutionally taxed. Indeed, subsequent decisions of this Court have indicated that the holdings in *Nichols*, *Blodgett*, and *Untermyer* are to be narrowly construed. See, *e.g.*, *Welch* v. *Henry*, *supra*, where those cases were not followed on the ground that "a tax on the receipt of income is not comparable to a gift tax" (305 U.S. at 148). And in *Cooper* v. *United States*, 280 U.S. 409, 412 (1930), the Court, in upholding the retroactive application of an income tax similarly refused to attach importance

moreover, that by increasing the stated rate of the minimum tax from 10% to 15% and reducing the exemption, Congress did nothing more than increase the effective rate of the minimum tax. See Staff of the Joint Committee on Taxation, 94th Cong., 2d Sess., *General Explanation of the Tax Reform Act of 1976*, at 105 (Comm. Print 1976).

3. In striking down the amendment to the minimum tax as applied to appellee, the district court reasoned that "[t]axpayers are not required to be aware of impending changes in the tax law in conducting their affairs, but may rely upon existing law with regard to taxes applicable to a voluntary transaction until such time as the law has been changed" (App. A, *infra*, 3a–4a). Whether appellee in fact relied upon the existing minimum tax rates is subject to considerable doubt (see page 4, note 6, *supra*). But even if appellee was aware of the minimum tax, the precedents of this Court establish beyond question that he was not entitled as a matter of law to rely upon the continued existence of the tax rates in effect at the time he sold his house.

Nor can appellee or any other similarly-situated taxpayer claim surprise at the amendments to the minimum tax. The proposed increase in the effective rate of the minimum tax had been under public discussion for almost a year before its enactment. As early as November 12, 1975, some eight months before the sale in question was consummated, Congress had evidenced its intention to raise the minimum tax rate and to reduce the allowable exclusions. See H.R. Rep. No. 94–658, 94th Cong., 1st Sess. 130–132 (1975), which proposed raising the minimum tax rate to 14%, reducing the exemption to a maximum of

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to the earlier estate and gift cases. There, the Court stated: "None of these cases [*Nichols*, *Blodgett*, and *Untermyer*] is in point; they gave no consideration to the power of Congress to require that taxable income should include profits from transactions consummated within the year."

$20,000, and reducing the deduction for regular taxes by one-half. On June 10, 1976, the Senate Finance Committee issued its report recommending an increase in the minimum tax rate to 15% and a reduction in the exemption to the greater of $5,000 or the amount of the regular tax liability. S. Rep. No. 94-938, 94th Cong., 2d Sess. 108-114 (1976).

The Tax Reform Act of 1976 reflected a compromise between these two proposals. Both the House and Senate bills, moreover, provided that the changes to the minimum tax were to be effective for all taxable years beginning after December 31, 1975. Thus, appellee had ample advance notice of the increase in the effective minimum tax rate. In these circumstances, the district court erred in holding that the effect of the increased minimum tax rate was "not only harsh and oppressive but basically unfair, and violative of the Fifth Amendment to the United States Constitution" (App. A, *infra*, 3a).

CONCLUSION

Probable jurisdiction should be noted.[12]

Respectfully submitted.

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[12] In light of this Court's governing precedents, the Court may wish to consider summary reversal.

APPENDIX A

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[Filed May 23, 1980]

IN THE UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF CALIFORNIA

CASE NO. F-77-192 Civ.

E. M. & B. L. DARUSMONT, PLAINTIFFS,

vs.

UNITED STATES OF AMERICA, DEFENDANT.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

This cause came on regularly for hearing of Plaintiffs' Motion for Summary Judgment on December 21, 1978, before the Court sitting without a jury. Michael C. Mitchell, Esq., appeared as counsel for Plaintiffs, and Mitchell B. Dubick, Esq., of the Department of Justice, appeared as counsel for Defendant. The Court having reviewed the record and having examined the proofs offered by the re-

spective parties, and the cause having been submitted for decision, and the Court being fully advised in the premises makes its Findings of Fact as follows:

FINDINGS OF FACT

It is true that:

1. During the month of May, 1976, Plaintiffs discussed several different alternatives for structuring the sale of their triplex apartments in Houston, Texas, with the real estate firm that handled the sale. Plaintiff ELVON M. DARUSMONT made his own basic analysis of the tax consequences of the various alternatives presented, concluded that an outright sale of the triplex apartments would be subject only to a capital gains tax, and confirmed this conclusion with friends and co-workers.

2. The conclusion made by Plaintiffs that an outright sale of their triplex apartments would be subject only to a capital gains tax was correct at the time the decision was made, as well as at the time of sale.

3. In September, 1976, Congress passed the 1976 Tax Reform Act, which was signed by the President on October 4, 1976. Its provisions affected the "minimum tax on tax preferences" by (a) raising the minimum tax rate from ten percent to fifteen percent, and (b) reducing the exemption to $10,000.00 or one-half of the regular tax liability, whichever is greater, which replaced the $30,000.00 prior exemption and deduction for regular taxes [Section 301 (g) (1) of the Tax Reform Act of 1976].

4. As a result of this retroactive aspect of Section 301(g)(1), Plaintiffs were subjected to $2,280.00 in additional federal income taxes which they could have completely avoided if they had selected one of the other two alternatives available to them with regard to the structuring of the sale of their triplex apartments.

5. On the basis of the tax laws that existed at the time of listing the property and at the time of sale, Plaintiffs could not have knowledgeably made a correct decision with regard to tax consequences.

6. Under the particular facts of this case, the amount of tax could not have reasonably been anticipated by Plaintiffs at the time of their voluntary act of fixing the terms of sale which the statute later increased the tax upon.

7. As applied to the facts of this case, Congress' retroactive amendment of the minimum tax on tax preference items subjected Plaintiffs' transaction to a new, separate and distinct tax to which it was not subject at the time Plaintiffs made their decisions regarding alternatives of sale and the tax consequences thereof.

The following Conclusions of Law, insofar as they may be considered Findings of Fact, are so found by this Court to be true in all respects.

From the foregoing facts the Court concludes:

CONCLUSIONS OF LAW

1. Since the taxpayer had the right to rely upon the tax laws as they existed at the time of sale, the retroactive application of the statute herein involved is so arbitrary and oppressive as to be a denial of due process.

2. It is not the nature of the tax that is objectionable, but the circumstances in which it is laid which makes it not only harsh and oppressive but basically unfair, and violative of the Fifth Amendment to the United States Constitution.

3. Taxpayers are not required to be aware of impending changes in the tax law in conducting their affairs, but may rely upon existing law with regard to taxes applicable to a

voluntary transaction until such time as the law has been changed.

DATED: May 23rd, 1980

/s/ _____
M. D. CROCKER
United States District Judge

APPENDIX B

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[Filed May 23, 1980]

IN THE UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF CALIFORNIA

Case No. F-77-192 Civ.

E. M. & B. L. DARUSMONT, PLAINTIFFS,

v.

UNITED STATES OF AMERICA, DEFENDANT.

JUDGMENT

Now, by virtue of the Findings of Fact and Conclusions of Law separately made by the Court, and filed herein,

IT IS ORDERED, ADJUDGED AND DECREED that Plaintiffs E. M. and B. L. DARUSMONT have judgment against, and recover from, Defendant the UNITED STATES OF AMERICA, overpayments in the sum of $2,280.00, made on April 15, 1977, together with interest thereon as provided by law, to a date preceding the issuance of the refund check by not more than thirty days, such date to be determined by the Commissioner of Inter-

nal Revenue, together with their costs to be taxed by the Clerk of the Court in the sum of $85.18.

DATED: May 23rd, 1980

/s/ _____
M. D. CROCKER
United States District Judge

APPENDIX C

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[Filed June 20, 1980]

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IN THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF CALIFORNIA

CIVIL NO. F-77-192

E. M. & B. L. DARUSMONT, PLAINTIFFS,

v.

UNITED STATES OF AMERICA, DEFENDANT.

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

NOTICE IS HEREBY GIVEN that the United States, defendant above-named hereby appeals to the Supreme Court of the United States from the final judgment of the United States District Court for the Eastern District of

California granting plaintiffs' Motion for Summary Judgment, entered in this action on May 23, 19 .

This appeal is taken pursuant to 28 U.S.C. §1252

HERMAN SILLAS
United States Attorney

/s/ _____
MITCHELL DUBICK
Counsel for Defendant

APPENDIX D

INTERNAL REVENUE CODE OF 1954 (26 U.S.C.):

SEC. 56 [as added by Section 301(a), Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 580] IMPOSITION OF TAX.

(a) [as amended by Section 301(a), Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1549] *General Rule.*—In addition to the other taxes imposed by this chapter, there is hereby imposed for each taxable year, with respect to the income of every person, a tax equal to 15 percent of the amount by which the sum of the items of tax preference exceeds the greater of—

(1) $10,000, or

(2) the regular tax deduction for the taxable year (as determined under subsection (c)).

* * * * *

(c) [as amended by Section 301(b)(2), Tax Reform Act of 1976, Pub. L. No 94-455, 90 Stat. 1550] *Regular Tax Deduction Defined.*—For purposes of this section, the term "regular tax deduction" means an amount equal to one-half of (or in the case of a corporation, an amount equal to) the taxes imposed by this chapter for the taxable year (computed without regard to this part and without regard to the taxes imposed by sections 72(m)(5)(B), 402(e), 408(f), 531, and 541, reduced by the same of the credits allowable under—

(1) section 33 (relating to foreign tax credit),

(2) section 37 (relating to credit for the elderly),

(3) section 38 (relating to investment credit),

(4) section 40 (relating to expenses of work incentive program),

(5) section 41 (relating to contributions to candidates for public office),

(6) section 42 (relating to general tax credit),

(7) section 44 (relating to purchase of new principal residence), and

(8) section 44A (relating to expenses for household and dependent care services necessary for gainful employment).

SEC. 57 [as added by Section 301(a), Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 580, and amended] ITEMS OF TAX PREFERENCE.

(a) *In General.*—For purposes of this part, the items of tax preference are—

* * * * *

(9) *Capital gains.*—

(A) *Individuals.*—In the case of a taxpayer other than a corporation, an amount equal to one-half of the net capital gain for the taxable year.

(B) *Corporations.*—In the case of a corporation having a net capital gain for the taxable year, an amount equal to the product obtained by multiplying the net capital gain by a fraction the numerator of which is the sum of the normal tax rate and the surtax rate under section 11, minus the alternative tax rate under section 1201(a), for the taxable year, and the denominator of which is the sum of the normal tax rate and the surtax rate under section 11 for the taxable year. In the case of a corporation to which section 1201(a) does not apply, the amount under this subparagraph shall be determined under regulations prescribed by the Secretary in a manner consistent with the preceding sentence.

* * * * *

TAX REFORM ACT OF 1976, Pub. L. No. 94-455, Section 301(g)(1), 90 Stat. 1553, provides:

SEC. 301. MINIMUM TAX

* * * * *

(g) EFFECTIVE DATE.—

(1) *In General.*—Except as provided by paragraph (4), the amendments made by this section shall apply to items of tax preference for taxable years beginning after December 31, 1975.

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Supreme Court, U. S.
FILED
JAN 10 1981
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No. 80-243

In the Supreme Court of the United States

OCTOBER TERM, 1980

UNITED STATES OF AMERICA, APPELLANT

v.

E. M. AND B. L. DARUSMONT

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF CALIFORNIA

SUPPLEMENTAL MEMORANDUM FOR THE UNITED STATES

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In the Supreme Court of the United States

OCTOBER TERM, 1980

No. 80-243

UNITED STATES OF AMERICA, APPELLANT

v.

E. M. AND B. L. DARUSMONT

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF CALIFORNIA

SUPPLEMENTAL MEMORANDUM FOR THE UNITED STATES

We wish to call the Court's attention to the recent decision of the Tenth Circuit in *Westwick* v. *Commissioner*, No. 79-2245 (Dec. 30, 1980). There, the court upheld the constitutionality of the 1976 retroactive increase in the minimum tax rate at issue in this case. For the convenience of the Court, we have set forth the opinion in the Appendix, *infra*.

Respectfully submitted.

WADE H. MCCREE, JR.
Solicitor General

JANUARY 1981

APPENDIX

PUBLISH

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

No. 79-2245

Filed Dec. 30, 1980

JOHN AND BARBARA WESTWICK,
PETITIONERS-APPELLANTS

v.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT-APPELLEE

Appeal from the United States Tax Court
(No. 7015-78)

Submitted on the briefs pursuant to Tenth Circuit Rule 9:

John Westwick, pro se.

Barbara Westwick, pro se.

M. Carr Ferguson, Assistant Attorney General, Gilbert E. Andrews, Grant W. Wiprud and Gilbert S. Rothenberg, Attorneys, Tax Division, Department of Justice, Washington, D.C., for Respondent-Appellee.

Before BARRETT, McKAY and LOGAN, Circuit Judges.

PER CURIAM.

After examining the briefs and the appellate record, this three-judge panel has determined unanimously that oral argument would not be of material assistance in the determination of this appeal. *See* Fed.R.App.P. 34(a); Tenth Circuit R. 10(e). The cause is therefore ordered submitted without oral argument. This is an appeal from the Tax Court's judgment for the Internal Revenue Service on a petition for redetermination of a deficiency in petitioners' income tax. The question presented by this appeal is whether the retroactive application of the 1976 amendments to the I.R.C. § 56 "minimum tax" violates petitioners' due process rights under the fifth amendment to the United States Constitution.

The parties have stipulated to the following facts. On September 13, 1976, petitioners entered into a contract to sell their duplex. On October 4, 1976, the same day the sale of the duplex was closed, the President signed the Tax Reform Act of 1976.[1] Section 301 of the Act reduced the amount of the exemption under I.R.C. § 56 to the greater of $10,000 or one-half of the taxpayer's regular tax liability, and increased the tax rate to fifteen percent of the taxable gain. Previously, the exemption was the greater of $30,000 or the regular tax liability, and the tax rate was ten percent. The amendments were made retroactive to cover items of tax preference for taxable years beginning after December 31, 1975. *Id.* § 301 (g). Thus, petitioners' transaction is subject to the new law unless their challenge is successful.

[1] Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520.

Petitioners reported a capital gain of $12,184.44 on the sale of the duplex, but claimed that no minimum tax was due under the law in effect on September 13, 1976, the date the real estate contract was signed. The IRS sent them a notice of a deficiency of $327.67, the amount due under the revised minimum tax provisions. Petitioners petitioned the Tax Court for a redetermination of the deficiency, alleging that the retroactive application of the amendments violated due process. The Tax Court held that applying the changes in the exemption and the rate to gains realized before the amendments became effective was constitutional under the standard set forth in Welch v. Henry, 305 U.S. 134 (1938).

It is well settled that an income tax may apply retroactively for limited time periods without violating due process. *E.g.*, Brushaber v. Union Pacific Railroad Co., 240 U.S. 1, 20 (1916); Stockdale v. The Insurance Companies, 87 U.S. (20 Wall.) 323, 331 (1873). The only revenue statutes held void for retroactivity involved wholly new types of taxes, a situation not presented in this case. *See, e.g.*, Untermyer v. Anderson, 276 U.S. 440 (1928); Blodgett v. Holden, 275 U.S. 142 (1927); Nichols v. Coolidge, 274 U.S. 531 (1927). The amendments petitioners complain of are best seen as changes in the base and rate of an existing tax. *See* Cohan v. Commissioner, 39 F.2d 540 (2d Cir. 1930). Petitioners refer us to no cases, nor can we find any, which invalidate the retroactive application of a mere change in a tax base or rate, whatever its size or significance. But petitioners argue that because such a substantial change in the minimum tax could not have been anticipated, the tax was in effect a new one which would have influenced their choice of disposition of

the duplex had they foreseen passage of the retroactive amendment.

In Welch v. Henry, 305 U.S. 134 (1938), the Supreme Court said:

> In each case it is necessary to consider the nature of the tax and the circumstances in which it is laid before it can be said that its retroactive application is so harsh and oppressive as to transgress the constitutional limitation.

Id. at 147. We agree with the reasoning of the Tax Court in the present case and in Buttke v. Commissioner, 72 T.C. 677 (1979), *aff'd.* 625 F.2d 202 (8th Cir. 1980), where the Tax Court also held that the retroactive application of the 1976 amendments to I.R.C. § 56 was not "so harsh and oppressive as to transgress the constitutional limitation." 72 T.C. at 679.

In Cohan v. Commissioner, 39 F.2d 540, 545 (2d Cir. 1930) the court (in an opinion by Judge Learned Hand) said:

> Nobody has a vested right in the rate of taxation, which may be retroactively changed at the will of Congress at least for periods of less than twelve months; Congress has done so from the outset. . . . [O]ne may indeed complain that, could he have foreseen the increase, he would have kept the transaction unliquidated, but it will not avail him; he must be prepared for such possibilities [*i.e.*, the retroactive increase in tax rates], the system being already in operation. His is a different case from that of one who, when he takes action, has no reason to suppose that any transactions of the sort will be taxed at all.

The judgment of the Tax Court is affirmed.

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Supreme Court, U.S.
FILED
OCT 20 1980
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

No. 80-243

UNITED STATES OF AMERICA,

Appellant,

v.

E. M. and B. L. DARUSMONT,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF CALIFORNIA

MOTION OF APPELLEES E. M. and B. L. DARUSMONT TO AFFIRM

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QUESTION PRESENTED

Whether Section 56 of the Internal Revenue Code of 1954, as amended by Section 301 of the Tax Reform Act of 1976, commonly referred to as the "minimum tax on items of tax preference", as applied retroactively to Appellees E. M. and B. L. Darusmont in 1976, denied Appellees due process of law under the Fifth Amendment to the Constitution of the United States.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

No. 80-243

UNITED STATES OF AMERICA,

Appellant,

v.

E. M. and B. L. DARUSMONT,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF CALIFORNIA

MOTION OF APPELLEES E. M. and B. L. DARUSMONT TO AFFIRM

MOTION TO AFFIRM

Appellees E. M. and B. L. Darusmont, pursuant to Rule 16.1(d) of the Rules of the Supreme Court of the United States, respectfully move that the final judgment of the District Court be affirmed on the ground that the judgment is so obviously correct as to warrant no further review by this Court.

OPINION BELOW

The findings of fact and conclusions of law of the District Court, which are not officially reported, are set forth in Appendix A of Appellant's jurisdictional statement. The judgment of the District Court, which is not officially reported, is set forth in Appendix B of Appellant's jurisdictional statement. These appendices, therefore, are not unnecessarily duplicated here.

JURISDICTION

The jurisdictional requisites are adequately set forth in Appellant's jurisdictional statement.

STATUTES INVOLVED

The pertinent provisions of the Internal Revenue Code of 1954, Sections 56 and 57 as amended by Section 301 of the Tax Reform Act of 1976, and, Section 301(g)(1) of the Tax Reform Act of 1976, are set forth in Appendix D of Appellant's jurisdictional statement.

CONSTITUTIONAL PROVISIONS INVOLVED

Amendment V

No person shall . . . be deprived of . . . property, without due process of law; . . ..

STATEMENT OF THE CASE

In April, 1976, Appellee E. M. Darusmont[1] was notified by his employer that he was to be transferred from Houston, Texas

[1] "Appellee" refers to E. M. Darusmont. B. L. Darusmont is a party to this action solely because she filed a joint return with her husband for 1976.

to Bakersfield, California (Darusmont Dep. 7-8). As a result, Appellee decided to sell his Houston triplex, consisting of a three-unit house in which he occupied one unit and rented the remaining two units (Darusmont Dep. 6-8).

In May, 1976, Appellee retained the firm of Coldwell, Banker & Company, a real estate firm well-known in the Western United States and listed on the New York Stock Exchange (referred to herein as "Coldwell Banker") to list the property and to advise him on the best way to sell the property (Darusmont Dep. 6-8).

Representatives of Coldwell Banker met with Appellee and suggested the following three ways to structure the sale as alternatives to selling the triplex outright for cash: (1) convert the three apartments to condominiums, and then sell Appellee's unit outright and the other two units on the installment basis with 30% of the purchase price down and the balance payable over five years; (2) sell the triplex as one unit on the installment basis with 30% of the purchase price down and the balance payable over five years; or (3) sell the triplex as one unit on the installment basis with 30% of the purchase price down and the balance payable over twenty-five to thirty years (Darusmont Dep. 8-11; Finding of Fact No. 1).

In connection with structuring the sale, Appellee and Coldwell Banker discussed the tax consequences of each of the alternatives, including capital gains taxes, the installment method of reporting, and the possibility of deferring a portion of the capital gain by purchasing another home in Bakersfield, California (Darusmont Dep. 8-11, 16-17; Complaint; Finding of Fact No. 1).

Appellee also discussed the tax consequences of the various alternative methods of structuring the sale with friends and co-workers (Finding of Fact No. 1).

Neither Coldwell Banker nor any of the friends and co-workers with whom Appellee discussed the tax consequences of the various methods of structuring the sale discussed with

Appellee whether the minimum tax on items of tax preference, as the law then existed, would apply to any of the methods suggested for structuring the proposed sale of the triplex (Darusmont Dep. 12-13, 16-17).

Appellee, after considering the ramifications of the various alternative methods of structuring the sale which were suggested to him, including practical considerations and the tax implications under the law as it then existed, and after computing what he projected to be his income tax liability, decided to sell the triplex outright. On July 15, 1976, Appellee sold the triplex as one unit, outright for cash (Darusmont Dep. 8-13, 16-19; Complaint; Finding of Fact No. 1).

Under the provisions of the law governing the minimum tax on items of tax preference, as in effect in May, 1976, when Appellee structured the proposed sale with the advice of Coldwell Banker and that of friends and co-workers, and as in effect on July 15, 1976, when Appellee sold the triplex outright, Appellee would not have owed any minimum tax in connection with the sale of the triplex (Finding of Fact No. 2).

On October 4, 1976, the President signed the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520. Section 301 of the Tax Reform Act reduced the amount of the exemption to $10,000 or one-half of the regular tax deduction, whichever is greater, which replaced the $30,000 prior exemption and deduction for regular taxes, and, increased the rate of the minimum tax from 10% to 15%. Section 301(g)(1) of the Tax Reform Act of 1976 made these changes to the minimum tax effective for taxable years beginning after December 31, 1975, that is, retroactive to January 1, 1976.

Had Appellee been aware of the changes to the minimum tax on items of tax preference made by the Tax Reform Act of 1976, subsequent to the sale but retroactive to January 1, 1976, he could have structured the sale of the triplex to completely avoid the minimum tax (Finding of Fact No. 4; Complaint).

Appellee regularly prepared his own federal income tax return, a practice he continued in 1976 (Darusmont Dep. 19).

However, because of the complications of the sale of the triplex and moving from Houston, Texas to Bakersfield, California, in March, 1977, Appellee retained a Certified Public Accountant in Bakersfield, California to review the return prior to filing for errors, omissions or potential tax savings (Darusmont Dep. 15-19).

After reviewing the return, the accountant informed Appellee that in preparing his return he had overlooked the minimum tax (Darusmont Dep. Exhibit A). The accountant informed Appellee that under the law as originally enacted and in force at the time of the sale, no minimum tax would have been due because of the amount of the exemption. However, the changes in the minimum tax enacted in October, 1976 and made retroactive to January 1, 1976, increased Appellee's income tax liability by $2,280 (Darusmont Dep. Exhibit A).

Appellee had no knowledge of the changes to the minimum tax on items of tax preference made by the Tax Reform Act of 1976 prior to having the "pencil draft" of his 1976 return reviewed by the accountant, except that he was casually aware from newspaper reports of the existence of the Tax Reform Act of 1976 (Darusmont Dep. 12).

Appellee timely filed a joint 1976 federal income tax return with his spouse showing a tax liability of $25,384, including the $2,280 in minimum tax, and timely paid this amount (Complaint). Appellee's Claim For Refund of $2,280 of minimum tax was denied, and he subsequently instituted the suit for refund which is the subject of this appeal.

ARGUMENT

THE RETROACTIVE APPLICATION OF THE MINIMUM TAX ON ITEMS OF TAX PREFERENCE TO APPELLEE IN 1976 WAS SO HARSH AND OPPRESSIVE AS TO DENY APPELLEE DUE PROCESS OF LAW

This Court has held that a retroactive income tax statute does not violate the "due process" clause of the Constitution *per se*. *See Milliken v. United States,* 283 U.S. 15 (1931). However, under certain circumstances, retroactive tax statutes have been held to deny due process of law as applied.

To determine whether or not a particular retroactive tax statute, as applied, denies due process, this Court has stated:

> In each case it is necessary to consider the nature of the tax and the circumstances in which it is laid before it can be said that its retroactive application is so *harsh and oppressive* as to transgress the constitutional limitation. *Welch v. Henry,* 305 U.S. 134 at 147 (1938) (emphasis added).

This Court and lower courts have developed three tests for determining whether or not a particular retroactive tax is so harsh and oppressive as to be a denial of due process, each of which has formed the basis of decision at least once that a particular retroactive tax was unconstitutional as applied. These three tests are:

1. Whether the taxpayer could have altered his behavior to avoid the retroactive tax if the nature or amount of the tax could reasonably have been anticipated by the taxpayer at the time the taxpayer engaged in the transaction;

2. Whether the taxpayer had notice of the tax when he engaged in the transaction; and

3. Whether the tax is a new tax, not merely an increase in the rate of an existing income tax.

1. APPELLEE COULD HAVE STRUCTURED THE SALE OF THE TRIPLEX TO AVOID THE MINIMUM TAX IF THE CHANGES TO THE MINIMUM TAX MADE RETROACTIVELY BY THE TAX REFORM ACT OF 1976 COULD REASONABLY HAVE BEEN ANTICIPATED BY APPELLEE PRIOR TO THE SALE.

The concept that certain retroactively imposed taxes arbitrarily impinge on voluntary behavior is rooted in the gift tax cases *Blodgett v. Holden,* 275 U.S. 142 (1927), modified, 276 U.S. 594 (1928), and *Untermyer v. Anderson,* 276 U.S. 440 (1928).

As stated by this Court in *Welch* in reference to these cases:

> In the cases in which this Court has held invalid the taxation of gifts made and completely vested before the enactment of the taxing statute, decision was rested on the ground that the nature or amount of the tax could not reasonably have been anticipated by the taxpayer at the time of the particular *voluntary act* which the statute later made the taxable event [citations]. *Since, in each of these cases, the donor might freely have chosen to give or not to give, the taxation, after the choice was made, of a gift which he might well have refrained from making had he anticipated the tax, was thought to be so arbitrary and oppressive as to be a denial of due process. Welch v. Henry, supra* at 147 (emphasis added).

In *Blodgett,* the Revenue Act of 1924, which was enacted on June 2, 1924, imposed a tax on all gifts made during the calendar year 1924. The taxpayer argued that the statute was unconstitutional as applied to gifts he made in January, 1924, prior to enactment of the statute. Due to an equal split in the opinion of the eight justices of this Court who considered the case, the Court did not rule on the constitutionality of the statute. However, four justices stated:

> As to the gifts which Blodgett made during January, 1924, we think the challenged enactment is arbitrary and for that

> reason invalid. *It seems wholly unreasonable that one who, in entire good faith and without the slightest premonition of such consequences, made absolute disposition of his property by gifts should thereafter be required to pay a charge for so doing. Blodgett v. Holden, supra* at 147 (emphasis added).

This view of *Blodgett* was subsequently adopted by a majority of the Court in its decision in *Untermyer, supra.*

Here, the outright sale of the triplex did not in fact subject Appellee to the minimum tax as it existed on the date of the sale. Subsequent to the sale, the Tax Reform Act of 1976 amended the minimum tax provisions retroactively to subject Appellee to the minimum tax in connection with the sale, a change in the tax laws which could not reasonably have been anticipated by Appellee at the time of the sale. If the changes to the minimum tax made by the Tax Reform Act of 1976 had been in effect at the time of the sale of the triplex or could have been anticipated, Appellee could have structured the sale so as to avoid the tax by selling the triplex on the installment basis.

Appellant apparently argues that since the evidence is conflicting as to whether Appellee actually relied in structuring the sale on the fact that the minimum tax as it then existed did not apply to the outright sale of the triplex, Appellee cannot now argue that he would have structured the sale to avoid the tax if he had been aware of it. The inference that Appellee would not have been aware of the new minimum tax law had it been in existence at the time of the sale cannot be drawn from the fact that Appellee may not have been aware of the minimum tax as it in fact existed at the time of the sale. If the changes to the minimum tax made by The Tax Reform Act of 1976 had been in effect at the time Appellee structured the sale, his advisors certainly would have called its existence to his attention since the effect of the changes, particularly the reduction in exemption, was to expose many more taxpayers and smaller transactions to the minimum tax than under the old law. Appellee, being a reasonably well-read layman, might very well have been personally aware of the changes.

In *Welch,* this Court, in upholding the retroactive imposition of an income tax on dividends by Wisconsin, stated:

> [T]here are . . . forms of taxation [other than gifts] whose retroactive imposition cannot be said to be similarly offensive, because their incidence is not on the voluntary act of the taxpayer . . . .
>
> [A] tax on the receipt of income is not comparable to a gift tax. We cannot assume that stockholders would refuse to receive corporate dividends even if they knew that their receipt would later be subjected to a new tax or to the increase of an old one. *Welch v. Henry, supra* at 147-148.

However, *Welch* is distinguishable from this case precisely because the incidence of the changes to the minimum tax made by the Tax Reform Act of 1976 did fall on the voluntary act of Appellee — the voluntary act of structuring the sale of the triplex so as to avoid the tax. As in the case of a gift, Appellee could have voluntarily altered his behavior to avoid the tax, an entirely different situation from the recipient of corporate dividends who, in effect, has no choice but to accept the dividends and pay whatever tax is imposed on such receipt.

Here, since Appellee could have freely chosen to structure the sale so as to avoid the minimum tax as amended by the Tax Reform Act of 1969, the retroactive imposition of the tax after Appellee's choice of a method to structure the sale, a choice which could have been and most probably would have been different had Appellee anticipated the tax, was arbitrary, harsh and oppressive.

2. APPELLEE DID NOT HAVE NOTICE OF THE RETROACTIVE CHANGES TO THE MINIMUM TAX WHEN HE SOLD THE TRIPLEX.

Here, although Appellee was casually aware of the existence of the Tax Reform Act of 1976, he had no actual notice of the proposed changes to the minimum tax which were subsequently enacted retroactively.

Appellant apparently argues that Appellee had *constructive* notice of the pending legislation as a result of certain Congressional Committee Reports, namely the House Ways and Means Committee Report on the House version of the bill, H.R. Rep. No. 94-658, 94th Cong. 1st Sess. (1975), issued in November, 1975, that is, in the calendar year prior to the year in which the transaction took place, and the Senate Finance Committee Report on the Senate version of the bill, S. Rep. No. 94-938, 94th Cong., 2d Sess. (1976), issued in June, 1976, that is, after Appellee had structured the sale in May, 1976.

Not only were these Reports issued months apart and in different calendar years, that is, in different fiscal periods, they each proposed different changes to the existing minimum tax. The House version proposed raising the minimum tax rate to 14% and reducing the exemption to a maximum of $20,000 and the deduction for regular income taxes to one-half of regular taxes, while the Senate proposed increasing the minimum tax rate to 15%, and reducing the exemption to the greater of $5,000 or the amount of the regular income tax liability, two divergent proposals eventually compromised in the Tax Reform Act of 1976 enacted in October, 1976.

It is untenable to require private individuals to follow proposed changes in the Internal Revenue Code through Congress, and, in fact this Court in *Untermyer* rejected this requirement. The government attempted to distinguish *Untermyer* from *Blodgett* on the ground that the gift in question was made three months after the Revenue Act of 1924 was passed, and while the Act was awaiting only the Conference Report, final Congressional approval and the signature of the President. In fact, the gift was made just twelve days before the Act was signed into law by the President. In rejecting the argument that the taxpayer had notice of the statute and in holding the Act unconstitutional as applied to gifts made prior to final enactment, this Court stated:

> The mere fact that a gift was made while the bill containing the questioned provisions was in the last stage

> of progress through Congress we think is not enough to differentiate this cause from the former one and to relieve the legislation of the arbitrary character there ascribed to it. To accept the contrary view would produce insuperable difficulties touching interpretation and practical application of the statute and render impossible proper understanding of the burden intended to be imposed. *The taxpayer may justly demand to know when and how he becomes liable for taxes—he cannot forsee and ought not to be required to guess the outcome of pending measures. The future of every bill while before Congress is necessarily uncertain. The will of the lawmakers is not definitely expressed until final action thereon has been taken. Untermyer v. Anderson, supra* at 445-46 (emphasis added).

Further, this case is distinguishable from three instances in which a retroactive income tax was found to be constitutional on the basis that the taxpayer had notice of pending legislation. In all three cases, the taxpayer was a sophisticated investor, who, having *actual* notice of the pending legislation, attempted to take advantage of a "loophole" before it was closed through the mechanism of a regulatory tax.

In *United States v. Hudson,* 299 U.S. 498 (1937), the plaintiff-taxpayer sold certain futures contracts in silver in late May of 1934. On June 19, 1934, the Silver Purchase Act was passed and made retroactive to May 15, 1934 (a period of 35 days). The court, in upholding the retroactive application of the statute, noted as the basis for its decision, the following facts:

> For some months prior to [May 15] . . . there was strong pressure for legislation requiring increased acquisition and use of silver by the government, and several bills providing therefor were presented in the Senate and House of Representatives. On May 22 the President sent to Congress a message recommending legislation for increasing the amount of silver in our monetary stocks and further recommending the imposition of a tax of at least 50 per

> cent. on profits accruing from private dealing in silver. The bill which became the Silver Purchase Act was introduced May 23 in response to this message. *United States v. Hudson, supra* at 501. (footnote omitted).

The transactions in *Hudson* took place at the time and shortly after the bill was introduced in direct response to the President's message. The bill was enacted 28 days after it was introduced and was made *retroactive for only 35 days.* It is obvious that tax was meant to and did reach those investors who, having actual notice of the impending legislation, attempted to profit prior to enactment of the statute.

Two recent cases considered the retroactive application of the Interest Equalization Tax Act of 1964, *First National Bank in Dallas v. United States,* 420 F.2d 725 (Ct. Cl. 1970), *cert. denied,* 398 U.S. 950 (1970), and *Purvis v. United States,* 501 F.2d 311 (9th Cir. 1974), *cert. denied,* 420 U.S. 947 (1975).

As in *Hudson,* a public issue, well-known to those few affected taxpayers, was involved. In discussing the public nature of the issue, the *Purvis* court stated:

> [P]resident [Kennedy] in his message [to Congress proposing the tax] made it clear that *if the tax was to achieve its purpose,* it was essential that legislation creating the tax be made effective as of the date of the Presidential message—July 18, 1963. *Otherwise, a rush by investors to beat the deadline would serve to aggravate the problem and render the proposal self-defeating.*
>
> The President's message was well publicized in the newspapers and financial journals. The market in foreign securities was promptly affected. On the day of the message the Treasury Department issued documents giving details of the proposed tax. A 'Notice of Proposed Effective Date' with a description of the proposed Act was published in the Federal Register on August 16, 1963. The Act in substantially the form proposed by the President was signed into law September 2, 1964, with an effective

date of July 18, 1963. *Purvis v. United States, supra* at 312 (footnote omitted) (emphasis added).

In upholding the constitutionality of the Act, the Court of Claims in *First National Bank in Dallas* stated:

> Although the interest equalization tax would raise a not insignificant amount of revenue, it is clear that the primary purpose of the tax was regulatory—to limit the outflow of long-term capital from the United States, and thereby alleviate the United States balance of payments problem. The retroactive aspect of the tax, moreover, was no mere embellishment; indeed, that aspect was a necessary prerequisite to the effectuation of the regulatory purpose. For if the interest equalization tax had not been proposed and enacted with retroactive effect, a premium would have been placed upon the consummation of 'covered' transactions prior to the tax's enactment date. Far from relieving the balance of payments problem, such a prospect would have intolerably aggravated the problem. That the public purpose served by the procedures invoked at the time of, and prior to, enactment was of the highest order cannot seriously be questioned. *First National Bank in Dallas v. United States, supra* at 730-31.

The court in *Purvis* further stated:

> We conclude, as did the Court of Claims [in *First National Bank in Dallas*] that with the widespread notice given to the investing public it cannot be said that retroactive application of this tax was oppressive or harsh or confiscatory. With the undeniable need for retroactive application in general if the *purpose of the tax* was to be realized, it cannot be said that retroactive application of this tax was arbitrary or capricious. *Purvis v. United States, supra* at 314 (emphasis added).

As in *Hudson, First National Bank in Dallas,* and *Purvis,* there is some justification in imputing actual notice of pending retroactive legislation where an identifiable, sophisticated group of taxpayers is involved, where the proposed legislation received widespread publicity in the media and through professional channels such as brokerage houses, and where the retroactivity serves the regulatory purpose of the tax.

Here, to the contrary, with no media coverage or fanfare, the House Ways and Means Committee, in November, 1975, reported out its version of the proposed Tax Reform Act of 1975. Six months later, the Senate Committee presented its proposal, and almost a year later the President signed the compromise version of the Act. The minimum tax provisions were made retroactive for a period of nearly one year.

Further, the proposed changes to the minimum tax were not a regulatory measure aimed at an identifiable group of taxpayers for the purpose of closing a tax "loophole", despite the fact that they were ultimately included in a "Tax Reform Act". The pertinent legislative history indicates that the primary purpose of the various changes to the minimum tax incorporated into the Tax Reform Act of 1976 was to raise revenue by ensuring that a larger group of high income individuals pay at least some income taxes. *See* Staff of the Joint Committee on Taxation, 94th Cong. 2d Sess., *General Explanation of the Tax Reform Act of 1976* (Comm. Print 1976).

Even assuming that a taxpayer is required to be aware of pending legislation, how far back in time should a taxpayer be expected to be knowledgable of the public record? Certainly, Appellee submits, no further back than within the fiscal year during which the taxable transaction takes place. Yet, when Appellee structured the sale of the triplex in May, 1976, there had been no public report of any proposal to change the minimum tax law within that calendar year. As Appellant admits in its Jurisdictional Statement at page 10, it was not until June 10, 1976, when the Senate Finance Committee issued its

report that there had been any public record of the proposal in calendar year 1976. S. Rep. No. 94-938, 94th Cong., 2d Sess. (1976).

Here, since Appellee had no notice, either actual or constructive, of the retroactive changes to the minimum tax at the time he sold the triplex, the retroactive imposition of the tax after the sale was arbitrary, harsh and oppressive.

3. THE MINIMUM TAX AS AMENDED BY THE TAX REFORM ACT OF 1976 WAS A NEW TAX, AS TO APPELLEE, NOT MERELY AN INCREASE IN THE RATE OF AN EXISTING INCOME TAX.

In *Cohan v. Commissioner,* 39 F.2d 540 (2nd Cir. 1930), Judge Learned Hand stated:

> Nobody has a vested right in the rate of taxation, which may be retroactively changed at the will of Congress at least for periods of less than twelve months; Congress has done so from the outset [citations]. . . . [I]t is no objection that upon occasion the result may disappoint reasonable anticipations. The injustice is no greater than if a man chance to make a profitable sale in the months before the general rates are retroactively changed. Such a one may indeed complain that, could he have foreseen the increase, he would have kept the transaction unliquidated, but it will not avail him; he must be prepared for such possibilities, the system being already in operation. *His is a different case from that of one who, when he takes action, has no reason to suppose that any transactions of the sort will be taxed at all. Cohan v. Commissioner, supra* at 545 (emphasis added).

Appellant argues that the changes made to the minimum tax by the Tax Reform Act of 1976 constituted merely a change in the income tax rates in effect at the time Appellee sold the triplex, and not a new tax.

To the contrary, the changes to the minimum tax made retroactively by the Tax Reform Act of 1976 imposed an entirely new tax as to Appellee on the sale of Appellee's property.

Congress has repeatedly stated that the minimum tax on tax preferences is a separate, distinct tax, computed separately and in addition to the regular income tax liability. For example, in its 1975 Report on proposed changes to the minimum tax, the House stated:

> [Y]our committee decided to keep the existing structure of the minimum tax, *which is in addition to regular tax liability,* . . . H.R. Rep. No. 94-658, 94th Cong., lst Sess. at 130 (1975) (emphasis added).

The provision of the 1976 Tax Reform Act changing the minimum tax reads as follows:

> (a) GENERAL RULE, — *In addition to the other taxes imposed by this chapter,* there is hereby imposed for each taxable year, . . . a tax equal to 15 percent of the amount by which the sum of the items of tax preference exceeds the greater of—
>
> (1) $10,000, or
>
> (2) the regular tax deduction for the taxable year . . . Section 301(a), Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520, 1549 (emphasis added).

The provision of the Tax Reform Act changing the minimum tax also provides at Section 301(f):

> For purposes of section 21 of IRC of 1954, the Amendments [to the minimum tax] made by this section *shall not be treated as a change in a rate of tax.* Section 301(f), Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520, 1553 (emphasis added).

Although Section 21 merely provides a method of computing tax when the rate of tax has changed during the taxable year,

this provision of the Tax Reform Act is further indication that Congress did not intend the minimum tax on tax preferences to be a change in the rate of income tax, but rather a separate tax from regular income tax liability.

Further, not only does the statute state that the minimum tax is in addition to regular income tax liability, and, therefore, by definition, not merely an increase in rate, the method provided in the statute for computing the minimum tax makes it impossible to compute the two taxes without treating them as separate and distinct. The taxpayer computes the minimum tax by adding up his "tax preference" items and deducting therefrom the greater of $10,000 or one-half of his regular income tax liability for the year. Since a taxpayer cannot compute the minimum tax on tax preferences without first computing his regular income tax liability, the two taxes are necessarily separate and distinct.

Appellee became subject to this separate tax for the first time when the changes to the minimum tax made by the Tax Reform Act of 1976 were enacted retroactively. At the time of the sale of the triplex, an outright sale was not subject to any minimum tax. As a result of the large decrease in the allowable exemption imposed retroactively, the transaction became subject to the minimum tax for the first time.

Thus, the objectionable aspect of the retroactive imposition of the changes to the minimum tax made by the Tax Reform Act of 1976 as to Appellee is not the increase in rate of minimum tax from 10% to 15%, but the reduction of the exemption from $30,000 to the greater of $10,000 or one-half of the taxpayer's regular income tax liability, which subjected a whole new class of taxpayers to the minimum tax, including Appellee.

This case is distinguishable, on this ground, from *Buttke v. Commissioner,* 72 T.C. 677 (1979), *affirmed,* No. 79-1885 (8th Cir. July 9, 1980). In *Buttke,* the taxpayer sold his farm in March, 1976, in a transaction which was subject to the min-

imum tax law as it *then* existed because of the large amount of capital gain involved. Subsequently, the Tax Reform Act of 1976 retroactively increased the minimum tax burden on the taxpayer in *Buttke.* Arguably, *Buttke* was correctly decided on its facts, since the retroactive changes to the minimum tax made by the Tax Reform Act operated as an increase in tax burden as to the particular taxpayer in *Buttke,* and not as a new tax.[2]

The retroactive imposition of the minimum tax after Appellee sold the triplex brought the sale of Appellee's triplex within the bounds of the separate minimum tax for the first time, that is, imposed a new tax retroactively as to Appellee, and, therefore, such retroactive imposition of tax was arbitrary, harsh and oppressive.

4. CONGRESS AND LOWER COURTS HAVE RECOGNIZED THE HARSHNESS AND OPPRESSIVENESS OF THE RETROACTIVE IMPOSITION OF CERTAIN INCOME TAXES, INCLUDING THE CHANGES TO THE MINIMUM TAX RETROACTIVELY IMPOSED BY THE TAX REFORM ACT OF 1976.

The Tax Reform Act of 1976 contained two retroactive provisions other than the minimum tax changes, a reduction in the exclusion for earned income abroad, and a reduction in the sick pay exclusion, both of which were made retroactive to January 1, 1976.

The earned income abroad exclusion applies to Americans working abroad. Prior to the Tax Reform Act of 1976, the law allowed taxpayers residing in foreign countries to exclude $20,000 to $25,000 of their income earned abroad from United States' taxation. The Tax Reform Act of 1976 reduced the exclusion by $5,000 retroactive to January 1, 1976.

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[2] Other courts have followed *Buttke* rigidly without close consideration of the particular facts in *Buttke. See* Appellant's jurisdictional statement, footnote 8; *Witte v. Commissioner,* T.C. Memo 1980-393 (1980).

Recognizing the harsh effect this retroactive change had on foreign residents, Congress in the Tax Reduction and Simplification Act of 1977, Pub. L. No. 95-30, 91 Stat. 126, eliminated the retroactive effective date of the provision and delayed its effective date to years beginning after December 31, 1976. The Report of the Senate Finance Committee stated:

> The application of the changes to the earned income exclusion to all income earned by individuals abroad beginning on January 1, 1976, substantially increased the tax burden of many of these taxpayers. Prior to the enactment of the Tax Reform Act of 1976 on October 4, 1976, these individuals did not know that they would be liable for substantially higher taxes and thus many had not saved the money to pay the increased taxes. As a consequence, the changes in the exclusion caused a particular hardship for 1976. S. Rep. No. 95-66, 95th Cong., 1st Sess. (1977).

The second retroactive provision of the Tax Reform Act of 1976 which was amended to apply prospectively only because of congressional concern with the unfairness of its retroactive application involved the sick pay exclusion. The Tax Reform Act of 1976 reduced or eliminated the exclusion of sick pay or disability income from gross income, thus working a hardship on many persons who expected to pay little or no tax on their sick pay or disability income. Recognizing this hardship, Congress in the Tax Reduction and Simplification Act of 1977 eliminated the retroactive effective date of this provision. The Report of the Senate Finance Committee stated:

> Although the Tax Reform Act of 1976 did not become law until October 4, 1976, the revisions in the sick pay exclusion were made applicable back to January 1, 1976. Even though the House version of the Tax Reform Bill, which passed on December 4, 1975, changed the sick pay provision prospectively (by applying the revisions to taxable years beginning after December 31, 1975), most of

> the taxpayers affected by the change were not aware of it. Consequently, many taxpayers were surprised to learn at the end of 1976 or early in 1977, that the sick pay exclusion was not available for 1976. For many of these taxpayers this change meant a large and unexpected final tax payment with their 1976 returns. For many taxpayers retired on disability pensions, such a large unanticipated cash payment represented a serious hardship. The committee believes that individual taxpayers should be given more advance warning when a change of this magnitude is made. S. Rep. No. 95-66, 95th Cong., 1st Sess. (1977).

The question arises as to why Congress did not also eliminate the retroactive effective date provision of the changes made to the minimum tax by the Tax Reform Act of 1976. A possible explanation lies in the observation that Americans living abroad and disabled persons are larger groups which tend to be organized and which are both represented before Congress by effective lobbyists. In any event, Congress subsequently recognized the harshness and oppressiveness of the only other retroactive provisions of the Tax Reform Act of 1976, and amended the provisions to apply prospectively only. Significantly, all of the changes made to the minimum tax by the Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2871, were made to apply prospectively only.

Lower courts have specifically recognized the harsh and oppressive effect of applying the changes made to the minimum tax by the Tax Reform Act of 1976 retroactively. In upholding the constitutionality of the changes to the minimum tax made by the Tax Reform Act of 1976, the Tax Court in *Westwick v. Commissioner,* T. C. Memo 1979-329, 38 TCM 1269 (1979), *appeal pending,* No. 79-2245 (10th Cir.), stated:

> Petitioner presented his position with sincerity and eloquence. We can understand his viewpoint. As a Court, however, we must take the law as written . . . [W]e have no choice but to sustain respondent's position. *Westwick v. Commissioner, supra* at 1271.

Similarly in *Buttke*, the Tax Court stated:

> Petitioners allege that the capital gain subject to the minimum tax here was a once-in-a-lifetime gain from the sale of a farm, that they are persons of modest means, and that under these circumstances the tax is harsh and oppressive. *While we are sympathetic with petitioners' plight, in light of the cases in which retroactive taxes have been upheld,* we cannot find the application of this tax "so harsh and oppressive as to transgress the constitutional limitation". *Buttke v. Commissioner,* 72 T.C. 677, CCH Dec. 36,174 at 3630-3631 (1979), *affirmed,* No. 79-1885 (8th Cir. July 9, 1980) (emphasis added).

Based on the special fact pattern in one instance and without complete analysis of the facts in the other, the Tax Court did not rule for the taxpayer in either case. However, in both instances, the Tax Court recognized the harsh and oppressive character of applying the changes to the minimum tax made by the Tax Reform Act of 1976 retroactively.

CONCLUSION

Wherefore, Appellees E. M. and B. L. Darusmont respectfully submit that the minimum tax on tax preferences, as applied to Appellees in 1976, was so harsh and oppressive as to deny Appellees due process of law, and, on the basis that the final judgment of the District Court is obviously correct in its decision to this effect, Appellees respectfully move the Court to affirm the judgment of the District Court for the Eastern District of California.

Respectfully submitted,

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No. 80-243

In the Supreme Court of the United States

OCTOBER TERM, 1980

UNITED STATES OF AMERICA, APPELLANT

v.

E.M. AND B.L. DARUSMONT

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF CALIFORNIA

REPLY MEMORANDUM FOR THE APPELLANT

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REPLY MEMORANDUM FOR THE APPELLANT

In seeking affirmance of the decision below, appellee argues (Mot. 6, 15-18) that the 1976 amendments to the minimum tax created a new tax that cannot reach transactions consummated prior to the date those amendments were signed into law. Second, appellee argues (*id.* at 6, 7-9) that despite the general rule upholding the application of income tax provisions to the entire year of enactment, an exception exists for "voluntary acts"—such as the sale of a residence—entered into prior to the date of enactment. Finally, appellee claims (*id.* at 6, 9-15) that he "had no notice, either actual or constructive" that the sale of his residence might have subjected him to the minimum tax and, consequently, that "imposition of the tax after the sale was arbitrary, harsh and oppressive" (*id.* at 15).

1. Contrary to appellee's first contention, the 1976 amendments to the minimum tax did not create a new tax. As we have noted (J.S. 8-9), the minimum tax was originally enacted in 1969. One of the original items of tax preference subject to the minimum tax was the untaxed portion of capital gain income. The only provisions changed in 1976 that affected appellee were the allowable exemption, which was decreased, and the percentage rate of tax, which was increased. Appellee therefore stands in a markedly different position from that of an individual who "has no reason to suppose that any transactions of the sort will be taxed at all" (*Cohan* v. *Commissioner,* 39 F. 2d 540, 545 (2d Cir. 1930)).

Furthermore, the minimum tax is an income tax which is intended to increase the income tax liability of persons whose regular income tax liability is disproportionately reduced as a consequence of claiming certain large deductions, *i.e.*, items of tax preference. See *Graff* v. *Commissioner,* 74 T.C. No. 58 (July 21, 1980), slip op. 40-44. Under the circumstances of this case, the economic effect of the 1976 amendments was to reduce somewhat the tax benefit of appellee's income tax deduction for fifty percent of net capital gains then permitted by Section 1202. That was not a new tax; it was only a change in the extent to which deductions would be allowed to decrease the impact of existing taxes. Under the decisions of this Court (see J.S. 6-7), it is well within Congress' authority to make such a change effective as of the beginning of the year of enactment.[1]

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[1]The minimum tax is imposed upon the sum of all the items of tax preference claimed for the taxable year. As in the case of the regular income tax, the minimum tax cannot be computed until after the close of the year.

2. Nor is it relevant that appellee's sale of his residence was a "voluntary act" (Mot. 9) that arguably might not have taken place (or might have taken a different form) if he or his advisors had considered the changed minimum tax provisions. Indeed, several of the Court's decisions upholding the application of income tax statutes to the entire year of enactment have dealt with "voluntary" acts. For example, in *Cooper* v. *United States*, 280 U.S. 409 (1930), the taxpayer, on November 7, 1921, sold stock that she had acquired by gift from her husband one week earlier. On November 23, 1921, however, Congress passed a revenue act providing that the basis of property received by gift after December 31, 1920, would be equal to that of the donor—*i.e.*, a carryover basis—instead of equal to the fair market value of the property at the time of the gifts, which had been the rule up until that date. Seeking to avoid using the lower carryover basis in computing her gain on the sale, the taxpayer argued that the new income tax provision should not be applied "to transactions fully completed before enactment of the statute" (280 U.S. at 411). This Court, however, rejected that contention, stating (*ibid.*): "That the questioned provision can not be declared in conflict with the Federal Constitution merely because it requires gains from prior but recent transactions to be treated as part of the taxpayer's gross income has not been open to serious doubt since *Brushaber* v. *Union Pacific R. Co.*, 240 U.S. 1, and *Lynch* v. *Hornby*, 247 U.S. 339."[2]

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[2]See *United States* v. *Hudson*, 299 U.S. 498 (1937) (voluntary sale of silver futures contracts held subject to special income tax provision enacted after the sale took place). See also *First National Bank in Dallas* v. *United States*, 420 F. 2d 725, 729-731 (Ct. Cl. 1970), where the court specifically rejected the claim that an income tax imposed on a voluntary act could not be applied retroactively.

Milliken v. *United States*, 283 U.S. 15 (1931), is to the same effect. There, in 1916, the decedent, in contemplation of his death, gave his children certain shares of corporate stock. Two years later in the Revenue Act of 1918, ch. 18, 40 Stat. 1057, Congress increased the estate tax rates for gifts made in contemplation of death. In holding that the new rates could be applied to the 1916 gifts, this Court rejected the taxpayer's arguments against application of the 1918 Act. As the Court stated (283 U.S. at 23):

> Not only was the decedent left in no uncertainty that the gift he was then making was subject to the provisions of the existing statute, but in view of its well understood purpose he should be regarded as *taking his chances of any increase in the tax burden* which might result from carrying out the established policy of taxation under which substitutes for testamentary gifts were classed and taxed with them. [Emphasis supplied.]

These decisions control this case and require reversal of the decision below.

3. It is therefore irrelevant whether appellee was aware of the impending changes in the minimum tax when he sold his residence. But, at all events, the public had ample notice of these changes. As we have pointed out (J.S. 9-10), on November 12, 1975—more than eight months prior to appellee's sale of his residence—Congress manifested its intention to increase the minimum tax rate and to reduce the allowable exclusions. See H.R. Rep. No. 94-658, 94th Cong., 1st Sess. 130-132 (1975). And on June 10, 1976, the Senate Finance Committee agreed in principle to the House proposals to increase the effective rate of the minimum tax. S. Rep. No. 94-938, 94th Cong., 2d Sess. 108-114 (1976). Each of these proposals,

moreover, provided that the changes in the minimum tax were to be effective for all taxable years beginning after December 31, 1975. Thus, prior to the time appellee sold his residence on July 15, 1976, it was public knowledge that the burden of the minimum tax liability likely would be increased with respect to transactions occurring during 1976.

For the reasons stated above and in our Jurisdictional Statement, probable jurisdiction should be noted.

Respectfully submitted.

WADE H. MCCREE, JR.
Solicitor General

NOVEMBER 1980

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